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MISSOURI LOTTERY

→ FINANCIAL STATEMENTS AS OF
JUNE 30, 1993 AND 1992
TOGETHER WITH AUDITORS' REPORT

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Missouri Lottery Commission:

We have audited the accompanying balance sheets of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1993 and 1992, and the related statements of revenues, expenditures and retained earnings, cash flows and changes in grand prize winners trust account for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1993 and 1992, and the results of operations, cash flows and changes in grand prize winners trust account for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen & Co.

St. Louis, Missouri,
October 6, 1993

MISSOURI LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1993 AND 1992

	<u>1993</u>	<u>1992</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash	\$ 16,310,998	\$ 12,729,233
Accounts receivable	9,413,671	2,248,898
Other receivables	22,495	200,361
Instant ticket inventories	-	130,890
Total current assets	<u>25,747,164</u>	<u>15,309,382</u>
PROPERTY AND EQUIPMENT	<u>4,338,644</u>	<u>3,620,159</u>
Total assets	<u>\$ 30,085,808</u> =====	<u>\$ 18,929,541</u> =====
<u>LIABILITIES AND RETAINED EARNINGS</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 5,754,973	\$ 2,700,906
Due to State of Missouri	8,742,520	5,326,894
Accrued prize liabilities	11,912,813	8,351,297
Other accrued liabilities	810,147	635,431
Capital lease obligations	116,336	108,296
Total current liabilities	<u>27,336,789</u>	<u>17,122,824</u>
CAPITAL LEASE OBLIGATIONS	196,215	304,354
OTHER DEFERRED LIABILITIES	2,552,804	1,502,363
RETAINED EARNINGS	-	-
Total liabilities and retained earnings	<u>\$ 30,085,808</u> =====	<u>\$ 18,929,541</u> =====

The accompanying notes are an integral part of these balance sheets.

MISSOURI LOTTERY

STATEMENTS OF REVENUES, EXPENDITURES AND RETAINED EARNINGS

FOR THE YEARS ENDED JUNE 30, 1993 AND 1992

	<u>1993</u>	<u>1992</u>
OPERATING REVENUES:		
On-line ticket sales	\$ 131,217,759	\$ 116,583,675
Instant ticket sales	114,692,661	97,104,051
Pull-tab ticket sales	10,764,925	6,672,027
	<hr/>	<hr/>
Total operating revenues	256,675,345	220,359,753
	<hr/>	<hr/>
OPERATING EXPENDITURES:		
On-line prize expense	68,475,376	58,291,838
Instant prize expense	62,975,056	52,617,414
Pull-tab prize expense	7,014,757	4,345,497
On-line retailer commissions and incentives	7,063,905	6,774,574
Instant retailer commissions and incentives	7,657,350	5,796,369
Pull-tab retailer commissions and incentives	870,693	536,762
Cost of tickets sold	7,993,413	7,530,306
Advertising and promotions	7,933,650	8,244,268
Wages and benefits	5,386,797	5,345,223
Other general and administrative	5,369,980	4,924,994
	<hr/>	<hr/>
Total operating expenditures	180,740,977	154,407,245
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Operating revenues over expenditures	75,934,368	65,952,508
	<hr/>	<hr/>
NONOPERATING REVENUES:		
Interest income	495,233	839,012
Other	165,754	263,615
	<hr/>	<hr/>
Total nonoperating revenues	660,987	1,102,627
	<hr/>	<hr/>
Income before transfers	76,595,355	67,055,135
	<hr/>	<hr/>
TRANSFERS TO STATE OF MISSOURI:		
Operating transfers	(76,595,355)	(67,055,135)
	<hr/>	<hr/>
Excess of revenues over expenditures and transfers	-	-
	<hr/>	<hr/>
RETAINED EARNINGS AT BEGINNING OF YEAR	-	-
	<hr/>	<hr/>
RETAINED EARNINGS AT END OF YEAR	<u>\$ -</u>	<u>\$ -</u>
	<u>=====</u>	<u>=====</u>

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1993 AND 1992

	<u>1993</u>	<u>1992</u>
CASH FLOWS PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Income before transfers	\$ 76,595,355	\$ 67,055,135
Adjustments to reconcile income before transfers to net cash used for operating activities-		
Operating transfers	(76,595,355)	(67,055,135)
Depreciation	775,447	896,029
Grand prizes deferred	14,935,528	18,665,812
Transfers to Grand Prize Winners Trust Account	(14,935,528)	(18,665,812)
Change in assets and liabilities-		
(Increase) decrease in accounts receivable	(7,164,773)	699,041
Decrease (increase) in other receivables	177,866	(178,936)
Decrease (increase) in instant ticket inventories	130,890	(54,792)
(Decrease) increase in accounts payable and other accrued liabilities	3,228,783	(206,960)
Increase in accrued prize liabilities	3,561,516	542,238
Increase in due to State of Missouri	4,466,067	972,889
Net cash provided by (used for) operating activities	<u>5,175,796</u>	<u>2,669,509</u>
CASH FLOWS FROM INVESTING ACTIVITIES- Additions to property and equipment, net of retirements	<u>(1,493,932)</u>	<u>(650,435)</u>
Net cash used for investment activities	<u>(1,493,932)</u>	<u>(650,435)</u>
CASH FLOWS FROM FINANCING ACTIVITIES- Payments on capital lease obligations	<u>(100,099)</u>	<u>(58,277)</u>
Net cash used for financing activities	<u>(100,099)</u>	<u>(58,277)</u>
Net increase (decrease) in cash	3,581,765	1,960,797
CASH AT BEGINNING OF YEAR	<u>12,729,233</u>	<u>10,768,436</u>
CASH AT END OF YEAR	<u>\$ 16,310,998</u>	<u>\$ 12,729,233</u>
	=====	=====

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

GRAND PRIZE WINNERS TRUST ACCOUNT

BALANCE SHEETS AS OF JUNE 30, 1993 AND 1992

	<u>1993</u>	<u>1992</u>
<u>ASSETS</u>		
INVESTMENTS	\$ 55,964,196 =====	\$ 41,719,711 =====
<u>LIABILITIES</u>		
DEFERRED GRAND PRIZE LIABILITY	\$ 55,964,196 =====	\$ 41,719,711 =====

MISSOURI LOTTERY

STATEMENTS OF CHANGES IN GRAND PRIZE WINNERS TRUST ACCOUNT

FOR THE YEARS ENDED JUNE 30, 1993 AND 1992

	<u>1993</u>	<u>1992</u>
TRANSFERS FROM MISSOURI LOTTERY	\$ 14,935,528	\$ 18,665,812
INTEREST ACCRETION	3,681,957	2,742,359
PAYMENTS TO GRAND PRIZE WINNERS	(4,373,000)	(2,427,000)
Net increase	<u>14,244,485</u>	<u>18,981,171</u>
BALANCE AT BEGINNING OF YEAR	<u>41,719,711</u>	<u>22,738,540</u>
BALANCE AT END OF YEAR	<u>\$ 55,964,196</u> =====	<u>\$ 41,719,711</u> =====

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1993 AND 1992

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Missouri Lottery (the Lottery) is accounted for as a proprietary type enterprise fund, is a component unit of the State of Missouri and is exempt from income taxes. The financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting and conform with practices generally followed in the gaming industry.

Revenue Recognition

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Powerball" games, and the daily "SUPERCASH" and "PICK 3" games. Sales of lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Sales of instant lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. In June 1993, the Lottery modified its collection policy on instant tickets sales to retailers, allowing the retailers to elect deferred payment terms, to encourage the retailers to carry large quantities and wider varieties of instant tickets. Retailers may select from zero to four weeks to delay payments for tickets received. Allowances have been established for estimated tickets to be returned by retailers of approximately \$404,000 and \$259,000 at June 30, 1993 and 1992, respectively.

Sales of pull-tab lottery tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to retailers and are valued at the sale price to the player.

Prizes

Expenditures for on-line lottery ticket prizes are recorded based on a minimum of 45% of on-line lottery ticket sales. The minimum grand prize amount for the semiweekly "LOTTO" game is \$1,000,000. The "LOTTO" grand prize claims are paid in 20 annual installments. Any prize that remains unclaimed for one year from the date of the on-line game drawing is used to fund future prize pools.

Expenditures for instant lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique, predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Cash

Cash consists of funds on deposit with the State Treasurer and banks. The cash on deposit with the State Treasurer is pooled with other Missouri state funds and is fully secured by the depository institutions holding the funds.

Retailer Fees

Licensed retailers are charged a fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectible accounts receivable from retailers. This reserve fund approximated \$564,000 and \$487,000 at June 30, 1993 and 1992, respectively, and is reflected as a reduction of accounts receivable on the accompanying balance sheets.

Ticket Inventories

Instant lottery ticket inventories consist of instant tickets purchased by the Lottery for new games which have not been implemented. Inventories are carried at cost, using the specific identification method. Tickets are charged to cost of tickets sold upon implementation of the game.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated life of the related asset. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

Due to Lottery Proceeds Fund and General Revenue Fund

All income before operating transfers of the Lottery, as described in the accompanying statements of revenues, expenditures and retained earnings, accrues to the benefit of the State of Missouri. Operating transfers through June 30, 1993, were required to be paid to the General Revenue Fund of the State of Missouri. All transfers on or after July 1, 1993, are to be made to the Lottery Proceeds Fund, which fund shall be appropriated by the State solely for the institutions of elementary, secondary and higher education.

Operating transfers are made monthly and are based on estimated income before operating transfers. A portion of the liability to the Lottery Proceeds Fund, equal to the net book value of capital additions after September 1, 1988, is deferred and is not subject to current operating transfers.

Supplemental Cash Flow Information

Cash paid for interest was \$26,134 and \$15,545 in fiscal 1993 and 1992, respectively. Total assets acquired in noncash transactions was \$-0- and \$470,927 in fiscal 1993 and 1992, respectively.

2. STATUTORY REQUIREMENTS:

Missouri statutes provide that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Legal and investigative services are provided by the Attorney General's office and the Missouri State Highway Patrol, respectively. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. ON-LINE TICKET SALES:

On-line ticket sales consist of the following:

	<u>1993</u>	<u>1992</u>
Powerball/Missouri Megabucks	\$ 47,405,923	\$ 31,475,374
PICK 3	33,634,482	29,042,335
LOTTO	32,462,902	43,011,602
SUPERCASH	17,714,452	13,054,364
	<u>\$ 131,217,759</u>	<u>\$ 116,583,675</u>
	=====	=====

4. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following:

	<u>1993</u>	<u>1992</u>
Land	\$ 184,512	\$ 184,512
Building	2,505,721	2,505,721
Computers and related software	2,105,525	2,007,080
Equipment	3,223,983	2,349,241
Autos	1,681,392	1,203,336
Equipment related to capital leases	507,536	507,536
Deposits on equipment	42,689	-
	<u>10,251,358</u>	<u>8,757,426</u>
Less- Accumulated depreciation and amortization	5,912,714	5,137,267
	<u>\$ 4,338,644</u>	<u>\$ 3,620,159</u>
	=====	=====

5. PENSION PLAN:

The Lottery participates with other state agencies in the Missouri State Employees' Retirement System (MOSERS) plan. The plan is a multiagency, defined benefit plan that covers substantially all of the Lottery's employees. The Lottery's contributions to the plan are set annually by MOSERS and, in fiscal 1993 and 1992, were approximately \$404,000 and \$408,000, respectively.

6. LEASES:

The Lottery's regional facilities are held under lease agreements that expire June 30, 1993, with renewal options available for one-to-four additional one-year periods. Annual rent expense for these facilities totaled approximately \$170,000 and \$165,000 in fiscal 1993 and 1992, respectively.

The Lottery leases instant and pull-tab vending machines under lease agreements that expire June 30, 1993, with options available for an additional one-year period. Annual lease expense for these machines totaled approximately \$109,000 and \$-0-, in fiscal 1993 and 1992, respectively.

Capitalized Lease Obligations

The Lottery leases computer equipment under capital leases expiring in fiscal 1996. The equipment may be purchased on any payment date during the respective lease period, at a predetermined price as stated in the respective lease agreements. These leases have been capitalized at an interest rate of 7.75%. Amortization on the capitalized amounts is included in depreciation expense.

Future minimum lease payments under the capital leases are as follows:

<u>Fiscal Year Ending</u> <u>June 30</u>	<u>Amount</u>
1994	\$ 124,830
1995	136,178
1996	77,677
	<hr/>
	338,685
Less- Interest component	26,134
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Present value of minimum lease payments	312,551
Less- Current maturities	116,336
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Long-term obligations	\$ 196,215
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7. CONTRACTUAL ARRANGEMENTS:

The Lottery maintains contractual arrangements with providers of goods and services critical to the Lottery's operations. Significant contracts include an agreement with the provider of the Lottery's on-line game computer systems and agreements with producers of the Lottery's instant and pull-tab games tickets, among others. The contracts generally run for one year, with one-year renewals available at the option of the Lottery. The contracts require the Lottery to compensate vendors for goods and services that meet stated quality standards.

The Lottery is a member of the Multi-State Lottery Association (MUSL) that consists of 15 state and district lotteries (member lotteries) and operates the on-line Powerball games. MUSL formerly operated the Missouri Megabucks and Lotto*America on-line games. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for the Powerball game and remit 50% (formerly 45% for Missouri Megabucks and Lotto*America) of sales to prize winners or to MUSL for payment of prizes. Member lotteries also fund MUSL's operating expenses, based on allocations by MUSL.

Grand prize winners of MUSL's Powerball, Missouri Megabucks and Lotto*America games receive prize payments annually over a 20-year period. Investment securities, with maturities that approximate all grand prize winner payments due to winners of MUSL games, are maintained by MUSL. The investments and related prize liabilities for winners of these games from the state of Missouri are excluded from the accompanying grand prize winners trust account statements. Future grand prize winner payments of MUSL games due to winners in Missouri are approximately \$143,140,000 as of June 30, 1993.

The Lottery has contributed to a prize reserve fund, separately maintained by MUSL, to protect MUSL members in case of unforeseen liabilities. With certain restrictions, the prize reserve fund monies are refundable to member lotteries upon termination of the member's agreement with MUSL or upon disbanding of MUSL. At June 30, 1993, the Lottery's portion of the prize reserve fund totaled approximately \$1,950,000.

8. GRAND PRIZE WINNERS TRUST ACCOUNT:

Prior to March 1990, the Lottery purchased annuity contracts from selected insurance companies to fund "LOTTO" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying balance sheets. Future installment payments to be made to grand prize winners by these insurance companies totaled approximately \$94,400,000 at June 30, 1993.

Since March 1990, to fund future payments under grand prize winner prize claims, the Lottery purchases U.S. Treasury zero coupon bonds, with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in the Lottery's name in safekeeping by the Federal Reserve Bank in a separate account for the grand prize winners trust account. The investments in these securities are carried at cost, adjusted for the accretion of discounts based on the purchase yield and the maturity date. Accretion on these investments is not recognized as revenue of the Lottery but is credited to deferred grand prize liability. These securities are not subject to trading and are intended to be held to maturity. The market value of these securities at June 30, 1993 and 1992, was approximately \$63,506,000 and \$44,109,000, respectively. The maturity value of securities held at June 30, 1993 and 1992, was \$102,720,000 and \$79,638,000, respectively.

In May 1993, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 115 concerning Accounting for Certain Investments in Debt and Equity Securities. This statement addresses the accounting and reporting for all investments in debt securities held by the Lottery. The statement is required to be adopted for fiscal years beginning after December 15, 1993, however, early adoption is encouraged. The Lottery has not determined the effects, if any, of the new statement on the Lottery's financial statements and disclosures, and has not determined in what fiscal year the statement will be adopted.

Scheduled grand prize installment payments to be funded by the maturing U.S. Treasury zero coupon bonds, as of June 30, 1993, are as follows:

<u>Fiscal Year Ending</u>	<u>Amount</u>
June 30, 1994	\$ 5,818,000
June 30, 1995	5,818,000
June 30, 1996	5,818,000
June 30, 1997	5,818,000
June 30, 1998	5,818,000
Thereafter	73,630,000
Total installment payments due	102,720,000
Less- Interest portion	46,755,804
	<u>\$ 55,964,196</u>
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